1812

THE NATIONAL CITY BANK OF NEW YORK EST. 1812

1953

Monthly Letter on

Economic Conditions Government Finance

New York, December, 1953

General Business Conditions

THE differences of opinion as to the business outlook which have been evident during the fall seem to be narrowing as the year-end approaches and specific statements of expectations for 1954 begin to appear. During the month it has been made clear that only a small reduction from 1953 levels of business plant and equipment expenditures is now intended, that the automobile manufacturers are laying out schedules on the assumption that well over 5,000,000 passenger cars can be sold next year, and that leading authorities on construction expect the drop in that field also to be slight. The McGraw-Hill survey of intentions to invest in plant and equipment indicates a decline of 8 per cent in manufacturing, no reduction by the utilities, and a drop of 5 per cent overall, which is from an all-time record. Passenger car output in 1954 will compare with something over 6,000,000 this year, which can hardly be repeated; but some forecasts run as high as 5,400,000 to 5,500,000, and Mr. Henry Ford II has stated that production in the early part of the year will reach new highs. As for construction, which continues to give strong support to business, the U.S. Departments of Commerce and Labor believe that the 1954 total will be only 2 per cent below 1953. Private forecasters such as the Dodge Corporation are not quite as optimistic, but nevertheless expect only a small recession.

These estimates form a consistent pattern of moderate decline, but one which will leave activity in these key industries high by any standards except those of 1953. Of course there is no assurance that the forecasts will prove correct, and some observers consider them too hopeful. Business sentiment in general, however, is tending to move from extremes of either pessimism or optimism into the middle ground.

Opposing Influences

The common reasons for expecting recession fall into three general groups. One is that demand earlier this year was temporarily swollen by inventory accumulation, in particular the replenishment of depleted steel inventories, and by the increase in sales financed by consumer borrowing. When expansion of inventories and consumer debt ceases, the expansion of demand also ceases to that extent. The second is that buyers are so well supplied with particular things, notably consumers' durable goods but including also items of capital equipment, that they necessarily will want less. The third is that during the long inflationary rise relationships between wages, costs and prices have got out of balance. Here the common reference is to the drop in farm prices and incomes, with the consequent decline in farm buying, but the impact of high money wages – and, in many cases, unsatisfactory productivity – upon industrial costs and margins may in the long run prove to be more serious. Personal debts are large, and can be repaid only at some cost in current buying power.

CONTENTS

While these are valid reasons for expecting demand to slacken, the supporting influences are equally impressive. Government demands for goods and services are not affected by changes in general economic conditions, and are relatively unshrinkable. In the present situation any small decline in federal demands is likely to be offset by further moderate expansion in local government projects and highway construction. Also, taxes are to be reduced.

Second, money has not "run out". On the contrary, lending institutions are sound and liquid, current savings are large, money policy is aimed at stability rather than restriction, and it would be hard to show that money is scarce or will become scarce for worthy projects or for carrying on a full volume of business. Individuals are estimated to hold nearly $200 billion of cash or cash-equivalent assets, which is an immense source of financial strength.

Third, by all signs inventory holdings are not predominantly speculative, for speculative excesses have been discouraged by the downward trend of commodity prices over the past two years.

Finally, the influences tending to maintain purchasing power in the event of recession, such as unemployment compensation, pensions and similar benefits, and farm price supports, work toward stability.

Out of these opposing influences the expectation of a moderate decline naturally develops. Business men see some recession coming, with need for reductions in cost and expense, and conservatism in buying. It would be plainly wrong to infer, however, that they are ready to take to the storm cellars, or that the outlook inspires dread. Rather a challenge is seen to the ability of management to meet harder conditions. Capital programs, undertaken for the purpose of improving products and reducing costs, continue aggressive in many areas.

In almost all lines producers who think they can do a better job than their competitors feel that they may be able to sell as much as in 1953, even though their industries, and business indexes generally, decline. A sampling by Dun and Bradstreet shows that only 19 per cent of the responding businesses expect their first quarter sales to be below the same quarter of 1953. It is also of interest that the magazine, Printers' Ink, estimates 1954 advertising expenditures at 4 or 5 per cent above this year.

The Current Situation

All these influences are seen in current business reports. New orders for many things are being placed conservatively, and unfilled orders in the main have been coming down. Evidently the change is not primarily due to decreased retail sales, for they have remained above a year ago despite disappointing sales of heavy-weight apparel, affected by the warm fall. Rather what is happening seems to be a disposition to shorten stocks and commitments. Probably inventory figures, which had continued to climb through September, the latest figures available, are due to level out or turn down. If so the reasons are plain. There are no fears of shortages, but general anticipation of plenty. In many lines deliveries are quicker, and it is therefore possible to reduce the "lead time" in buying. This affects the order books of producers even in cases where consumption and production are essentially unchanged.

Industrial production in November was somewhat lower in steel and consumer durable goods lines, but seemingly steady in most other areas. Department store and retail sales showed signs of improvement with crisper weather and holiday trade. Construction remains an unexpected bulwark, with contract awards in October 45 per cent ahead of last year. Automobile manufacturers slowed down production beginning in early November because of high dealer stocks and model changeovers, but output is expected to begin to increase again in early December and — with producers striving to hold or improve their share of the market — to rise thereafter as Mr. Ford has indicated.

Steel activity has eased somewhat along with automobile, appliance, and farm machinery slowups. Output in November averaged around 90 per cent of capacity compared to 95 per cent in October. Customers have been giving steel mills reassuring estimates of next year's requirements, but as yet the actual orders have been slow to materialize, and the tendency to reduce lead time is evident. Machine tool orders are still running behind last year, and the backlog is being whittled away; but production remains steady. Price reductions announced during the month which indicate slower buying or enlarged supply include gasoline and fuel oil, some new model automobiles and appliances, carpeting, and industrial alcohol.

Personal income ceased to increase last August, though it holds above last year. Lower factory payrolls, reflecting reductions of overtime, have caused the flattening out. Recent layoffs may have some further depressing effect. However, most layoffs appear to be of short duration, since reported unemployment in October was less than 1,200,000, a postwar low for

the month. Although unemployment compensation claims have increased slightly they are still lower than earlier in 1953. The total number of employed workers remains practically stationary, however, which indicates that "over-employment" is subsiding and some people are retiring from the labor force.

Consumer Attitudes

The University of Michigan Survey Research Center has recently completed another of its inquiries into consumer attitudes, which finds that many people consider this a good time to buy because they look for stable prices and also expect their family finances to be better next year. Buying sentiment is not as strong as a year ago, but it is stronger than in the fall of 1951. A sizable portion of families think there will be some bad times in the next five years, but good times are expected for the next twelve months. These surveys, which have been a good gauge of sentiment in the past, cannot be turned into sales figures; but the findings should give encouragement.

It is of interest to inquire why people still seem relatively optimistic, despite published downturns in business indexes and the widespread expectations of moderate recession. Possibly the answer is that people know that their desires and buying inclinations are unimpaired. Manufacturers and business analysts may think in terms of saturated markets, but consumers seldom do. They know the truth of the statement that human wants are unlimited – a truth that obviously does not apply to every specific thing at every time, but that is indisputable when applied to desires in the aggregate at all times. Everyone knows it would be idle to suggest that even American living standards have reached their maximum or that expansion of American productive facilities will ever cease.

In last analysis, what is producing the expectations of business decline in 1954 is the concept of a "gap" as compared with 1953. The gap represents prospective reductions in demand for capital goods, automobiles and housing, and prospective cessation of inventory stocking. What this may amount to in dollar terms would be hard to predict, but in any event it can represent only a trifling percentage of the total potential production and markets of the country. The gap can be narrowed by success in developing new and better goods for the market, or by making old products at lower costs; and by flexibility in production planning and the use of resources to give people what they want. Needless to say, this effort requires the cooperation of industrial management and labor, directed toward the goal of reducing unit costs.

Treasury Financing

The Treasury late in November undertook its ninth, and final, major financing task of 1953, this time to cover a maturity of $10,042 million 2⅛ per cent Treasury notes due December 1. Holders of the maturing notes were invited to exchange their holdings for twelve and one-half month 1⅞ per cent notes due December 15, 1954 or five year 2½ per cent bonds due December 15, 1958. Exchange subscription books were open for three days, November 18-20. The double-barreled offering and a favorable market gave assurance of a successful result, not to mention the fact that the Federal Reserve Banks had $6,992 million of the maturing issue to exchange.

While the subscription books were open, demand for the 1⅞s and 2½s created a premium of about 10/32nds of a point on the maturing notes for the exchange privilege they carried. Holders of the 2⅛s needing cash at maturity were thus tempted to sell out, reducing to modest proportions the drain on the Treasury for cash redemptions. At the close of trading on November 30 the new 1⅞ per cent notes were quoted in the market at 100 9/32 to yield 1.60 per cent; the 2½ per cent bonds at 100 13/32 to yield 2.41 per cent.

Earlier in November, in an unusual transaction involving only the Treasury and Federal Reserve, the size of the December 1 note maturity had been reduced by $500 million. Previous to November 9 the Federal Reserve Banks' holdings had been $7½ billion and the total issue had run to $10½ billion. On November 9 the Treasury issued $2.2 billion 2¾ per cent bonds of 1961, sold for cash to finance the deficit. In order to keep within the $275 billion legal limit on the public debt, the Treasury on the same day purchased $500 million of the December notes from the Federal Reserve for immediate cash redemption. To effect the purchase the Treasury drew on the $1 billion of unobligated or "free" gold in its general fund balance. This transaction correspondingly reduced Treasury cash balances and Federal Reserve holdings of government securities with no effect upon the money market. The need for tapping the free gold indicates the pressure the Treasury is under to keep within the debt limit.

Results

The Treasury announced on November 24 that subscriptions totaled $8.2 billion for the twelve and a half month notes and $1.7 billion for the five-year bonds; unexchanged notes, requiring

cash redemption on December 1, amounted to only $122 million. The heavy Federal Reserve holdings were exchanged for the new notes. The public holdings of $3050 million were converted into the twelve and a half month notes to the extent of 39 per cent, traded for the five-year bonds to the extent of 57 per cent, and left for cash redemption to the extent of 4 per cent. As the following table shows, this is the highest percentage yet realized for a longer term issue on any of the three double-barreled exchange offerings attempted this year.

1953 Treasury Optional Refundings

(Dollar figures in millions)

Maturity	Public Holdings	Not Exchanged	Exchanged for 1-year Cert.	Exchanged for Bonds
Feb. 15 cert....	$5,180	$134 (3%)	$4,426 (85%)	$ 620 (12%)
Sept. 15 bonds	7,130	263 (4%)	3,867 (54%)	3,000 (42%)*
Dec. 1 notes....	3,050	122 (4%)	1,179 (39%)†	1,749 (57%)

* "Long" notes maturing March 15, 1957.
† "Short" notes of 12½ months' term.

In February the holders of maturing certificates were offered a choice between new one-year certificates paying 2¼ per cent and 2½ per cent bonds due December 1958. Market conditions were developing unfavorably in the bond market and only 12 per cent of public holdings were exchanged for the bonds. The December 1958 2½s went as low as 97 at the bottom of the bond market June 2 and the Treasury simply offered one-year certificates to meet the certificate and bond maturities of June 1-15, and the certificate maturity of August 15. In September the double-barreled technique was revived to meet a maturity of 2 per cent bonds, the choice consisting of one-year 2⅝ per cent certificates and three and one-half year 2⅞ per cent notes due in March 1957. This brought a better result than the effort of February, mainly because of improving market conditions.

A Complete Recovery

The ability of the Treasury now to put across one year paper at 1⅞ per cent and five year bonds at 2½ per cent is an indication of the further improvement in the market since the September financing terms were set. This improvement is based on Federal Reserve measures to increase the supply of credit and on a failure of business credit demands to develop this autumn in the usual degree.

The 2½ per cent bonds due December 15, 1958 offered in exchange for the December 1 note maturity is the same issue originally put out February 15. In the spring money pinch, when these bonds sold as low as 97, few people would have ventured to suggest that, before the year-end, it would be possible to place another $1.7 billion of the issue at a par level. The success of the Treasury with the reopening of the 2½ per cent bonds is a signal of the completeness of the recovery in the government bond market.

Even more striking is the improvement in the short-term market. The last time the Treasury raised one-year money at 1⅞ per cent was back in July 1952. The one-year rate climbed from 2¼ per cent in February of this year up to 2⅝ per cent on issues put out June 1, August 15 and September 15. Thus the new 1⅞ per cent shaves a full ¾ per cent off the one-year rate used only two and one-half months ago.

What Good in Fluctuations?

Now that rates on government securities are back where they started a year or a year and a half ago, the question is asked: "What good did it do to have money rates rise as they did, and the money and capital markets tighten up as they did, in the first five months of the year?" Certainly, as seems implied in the question, the credit developments of 1953 have the outward appearance of an attack upon inflation followed by a hasty retreat to cheap and depreciating money. But this outwardly plausible interpretation overlooks the change in the business climate since last spring and the fact that the monetary authorities must be guided by conditions as they develop. It ignores any contribution the spring money pinch made to repress inflationary forces then at work. What assurance is there that the record of stability in prices — as well as in production, trade and employment — would have been realized if lenders and borrowers alike had not had to do some recalculating of what they could undertake?

To bankers, dealers, insurance executives, corporation treasurers, and trustees managing bond portfolios, the 1953 experience has been a lesson in the ways of free markets and in the importance of giving heed to the fundamentals of credit supply and demand. Coming as a climax to the original freeing of the market in 1951, and the wider range of officially tolerated fluctuations in 1952, it has taught the wisdom of spacing out maturities, the costliness of unwarranted fears at the bottom of a market, and the profits that can come from buying when panic is in the air. Certainly the government bond market, so long wet-nursed by constant official intervention and price-pegging, is a better experienced market now than it was a year ago.

Budget Balancing by Definition

Against a background of the twenty years' shrinkage in the value of the dollar, the Administration has set the course of the Federal Gov-

ernment — in the words of Treasury Secretary Humphrey — "firmly toward the soonest possible balancing of the budget." The task is a tough one. For the current fiscal year ending June 30, 1954, the Congress and Administration have lopped enough off the outlays projected by the Truman Administration to reduce the threatened $9.9 billion deficit to $3.8 billion. Further cuts have been harder to find and Administration spokesmen admit that, even with prosperous business, balancing the budget in the following fiscal '55 will be difficult. Meanwhile, the public debt has risen to its $275 billion statutory limit and it is recognized that Congress may be forced to do what it rebelled at doing last summer — namely, raise the limit.

Complicating the problem of balancing the budget are the tax reductions provided in existing law. The Administration is committed to the loss of $5 billion revenue through the scheduled easing of personal income taxes and the lapse of the corporate excess profits tax on January 1. Present law provides for easements of corporate income and excise taxes on April 1, 1954, though here the Administration has urged extension or substitution of other taxes in the hope that, with these revenues retained, a balanced budget in fiscal '55 can be realized.

Since a balanced budget slows the pace of the tax relief that everyone wants, it is not strange that people find attraction in suggestions recently heard that the budget really is not out of balance; that if the accounts were only kept right there would be no deficit and the coast would be clear for more tax cuts.

The Ruml Budget

Along this line Mr. Beardsley Ruml of New York, president of the Jewelers Acceptance Corporation, formerly chairman of the board of R. H. Macy & Co., and well known for his authorship of the "pay-as-you-go" system of personal income taxation put in force in 1943, stirred wide interest when he testified before the House Ways and Means Committee August 12 that three "budget reforms" would improve the budget picture by $10 billion, or enough not only to eliminate the deficit but also to give leeway for tax reductions running considerably beyond those which the Administration has recommended.

Mr. Ruml indicated that the federal budget (1) improperly includes $2 billion "capital items" treated as expense; (2) includes $4 billion investments that could be organized as "self-financing" authorities; and (3) excludes $4 billion net receipts of social security trust funds. At the same time he stated his belief that another $2 billion could be saved by increased efficiency and economy, though this was apart from the question of government accounting methods. The present budget he disparaged as unbusinesslike, as "a hodge podge of current and accrued items," as "only a listing of numbers with no overall financial meaning."

This is a severe indictment. The present budget, with all its thorny complications, gives in its 1,000 pages the fullest disclosure of financial transactions, probably, of any government in the world. It is based, fundamentally, on the simplest and most readily understandable of bookkeeping systems, namely cash accounting. Thus, if the budget balances, there is no need to increase the public debt; if it is overbalanced, the public debt can be reduced; if it is underbalanced, the public debt must be increased.

Mr. Ruml's budget would add trust fund receipts, not counted in the revenues at present, and leave out expenditure items to be financed by increasing the public debt directly or indirectly. The plan would be without effect if Congress held firmly to the public debt limit inclusive of government guaranteed items and accruing liabilities to the social security trust funds. In a nutshell, it comes down to a government spending plan of borrow-as-you-go to relieve the taxpayer.

The "Cash Consolidated" Budget

The main exception from cash accounting in the Federal Government arises from the fact that trust funds are segregated from the budget. The trust funds, the largest of which is the Old Age fund, currently have nearly $4 billion a year coming in over and above their outlays. Mr. Ruml would take this $4 billion into the budget, to this extent accepting the principles of the "cash consolidated budget" which measures government income and outgo in terms of total cash flows in and out of the Treasury.

Many people consider the cash consolidated figures the best measure of the inflationary or deflationary effect of federal finances. Cash consolidated budget figures have been included in recent years as an appendix to the regular budget. They have been referred to frequently in the President's Economic Messages to the Congress. They are very close to a balance in the current fiscal year.

Mr. Ruml gives the cash consolidated budget a blanket endorsement but it is clear that his approval extends only to counting all the cash coming in as spendable revenue. On outlays he would discard the cash consolidated idea. He would exclude, to be financed through direct

borrowing or through borrowing by so-called self-financing agencies, outlays for loans, investments in mortgages and commodities, and costs of real estate, buildings, and atomic energy plants. He would add to expenditures bookkeeping charges for rent on government-owned buildings, losses and depreciation.

Extraordinary Financing

We have ventured into this morass before. In 1932 the RFC was set up to provide emergency loan funds and to liquidate itself over a two-year period. It was granted $500 million capital, charged as an expense in fiscal '32, but was also given the right to borrow on its own name with a government guarantee. Over the period 1934-40 President Roosevelt split off extraordinary expenditures from the ordinary budget, in part on the theory that these represented "permanent, tangible additions to our national wealth", and on the premise that the debt incurred to cover them would be paid off when the depression came to an end.

These plans failed to work out. When war came the extraordinary budget became the defense budget, the Treasury took over the RFC's debts, and the wartime deficits absorbed the RFC's losses. In the postwar period, with minor exceptions, the budget has been presented as a whole, inclusive of the so-called self-liquidating enterprises. The RFC, after a checkered career as lender and spender of $30-odd billion of public funds, is now finally in liquidation.

Extraordinary budgets and extraordinary financing have a place in war or depression emergency. In peacetime prosperity they have no such excuse, and they provide a wide open channel to a national government that is embarked on socializing the means of production. The present Administration rejects this philosophy; effort is being made to get the government out of business. This effort helps balance the budget, cutting out the drains of funds into government business enterprises and bringing a realization on investments previously made.

Government Accounting Unbusinesslike?

The charge that government accounting of expenditures is unbusinesslike has been made many times. Mr. Everett M. Kassalow, executive secretary of the CIO's Full Employment Committee, asked the rhetorical question in hearings on November 23, 1949 before the Douglas subcommittee investigating monetary, credit and fiscal policies:

> . . . why is it that when a private utility company floats a bond issue and uses the funds thus obtained to build a new power plant or a series of transmission lines, it is entered on the books as an asset; yet, when a Government agency, a TVA or the like, borrows money and does the same thing, it becomes an all-terrible public debt, with nothing good to be said for it.

In the accounting parlance, the idea is that the Government should have a capital budget, "capitalize" its power plant as an asset in a balance sheet, borrow money to pay for it, and defer the charge of expense into the future.

During the course of the same hearings Mr. Frank Pace, Jr., Director of the Budget Bureau, approved *listing* capital outlays in the budget but saw dangers and difficulties, and little purpose, in a capital budget. He stated:

> In terms of actual formal budget presentation, however, I have two strong objections to the capital budget. One is that a capital budget requires depreciation. To set up a depreciation in some large-scale operations of the Federal Government should be so complex and cumbersome as to be fundamentally meaningless.
>
> In the second place, the problem of determining what is a capital asset is an extremely complex one. For example, is military equipment a capital asset? Eventually the determination must be made by an individual or group of individuals.
>
> In the long run, your ability to control fiscal policy could be materially weakened with a governmental capital budget. Since business is operated on a profit motive, it has little problem in the presentation of a capital budget. Since Government is in business to protect and serve the people, however, and its motivation is essentially different, the presentation of the Government's budget on a capital basis would serve little purpose.

The President's annual budgets, beginning with that for fiscal '51 issued in January 1950, have contained schedules of prospective additions to federal assets. For fiscal '54 the figure is given as $26.6 billion, mostly military items which are subject to unusual hazards of obsolescence, depreciation, and utter destruction. The budget, while noting the totals, offers no calculation of the extent to which these outlays are necessary simply to offset depreciation and obsolescence of the existing stock of armaments, deterioration of surplus farm products held in storage, etc.

Balance Sheets and Accrual Bookkeeping

Business corporations generally use the accrual system of bookkeeping and publish balance sheets of assets and liabilities which reconcile the results of operations with changes in cash balances, debt, and capital funds. Independent audits, requirements of full disclosure by Stock Exchange and SEC regulations, and reviews by directors and shareholders provide protection against accounting abuses. Corporate use of accrual bookkeeping is practically compulsory under the tax laws; moreover, a full listing of assets is necessary to support borrowing power.

The Government has no need to use accrual bookkeeping either to satisfy tax collectors or creditors. Government activities are of such unparalleled size and variety that even a cash accounting system is hard enough for the Congressman and the citizen to master.

The federal budget does not provide a full balance sheet. The footings on such a balance sheet, if available, would be swollen by the accumulations of past deficits represented in the present $275 billion debt total, to say nothing of the tens of billions of contingent liabilities the Government has assumed on guarantees of mortgages and other obligations. No conservative appraisal of loans and physical assets held by the Government, with due allowances for losses, depreciation and obsolescence, could match the total of liabilities. To get a balance it would be necessary to insert a figure for the Government's main revenue-producing "asset", its ability to levy taxes.

This "asset" is being exploited for all it is worth. Even so the revenues are not big enough to pay down the accumulated deficit.

When Pay for War?

Senator Byrd of Virginia on September 21 made public a letter he had written to Chairman Reed of the House Ways and Means Committee in reference to Mr. Ruml's testimony. He said the latter's proposal "would set back budgetary disclosure twenty years to a point where government corporations were springing up over night, as a sort of fourth branch of government, conducting so-called business-type operations by the exploitation of federal credit completely outside of budgetary, appropriation, accounting or any other fiscal control." He indicated his belief that:

> With its facilities for hiding government encroachments on free enterprise, the Ruml proposal would be an open invitation to creeping socialism, but as justification for tax reduction, or as an improvement in federal budgetary procedure it would be a hoax.

Senator Byrd denied that government "is in business to make a profit on its services to citizens." Indeed, the paramount function of any national government is to provide defense against catastrophe. The present $275 billion federal debt was incurred mainly to finance two world wars and one major depression. While proponents of a capital budget conveniently ignore the question, it is only proper to insist, if we are going to have business-type accounting, upon some reasonable amortization of the debt that represents the accumulated deficits from past wars and depression.

All other items in the U.S. budget are overshadowed by the cost of past and threatened future wars. We have never been able to finance a major war on a pay-as-you-go basis. Likewise, business depressions bring deficits and force the national debt upwards. The only course of policy that will defend the value of the dollar and the national credit is the one traditionally employed: namely to work off emergency-incurred debt, and to cover so-called capital outlays out of current revenues, during peacetime prosperity.

Practice Abroad

The United States has made sparing use of extraordinary budgets to justify public borrowing. Abroad there has been a larger experience although not one calculated to instill confidence in the idea. The United Nations, in a pamphlet issued in February 1951 on "Budgetary Structure and Classification of Government Accounts", specifically warns against the use of a distinction in current and capital accounts as "justification for borrowing to finance increases in net assets". Under this stricture the distinction Mr. Ruml would draw between capital and current outlays would not save the U.S. taxpayer any burden.

Among countries carrying extraordinary items outside their regular budgets, Canada qualifies as a nation that adheres closely to the principle set out in the UN document. Canada maintains a system of partial balance sheet accounting, and publishes figures on *net* public debt derived by subtracting from gross debt such items as cash balances, investment in its own securities, loans to the United Kingdom and other governments, and certain loans to and investments in government corporations. These items on March 31, 1953 added to $6.7 billion after allowance for a $0.5 billion loss reserve built up by charges against the regular budget. Thus the net debt was calculated at $11.1 billion against a gross debt of $17.8 billion.

The Canadian Government has financed its postwar capital outlays within a budget balanced overall. The regular budget surplus over the six years ended March 31, 1953 amounted to $1.9 billion and the net debt declined correspondingly from $13.0 to $11.1 billion. The gross debt at $17.8 billion on March 31, 1953 was $0.1 billion higher than six years before but the level of cash balances was raised $0.8 billion indicating a surplus for the six years on an overall basis.

Adoption of the Canadian model of limited capital accounting would not save the U.S. taxpayer any considerable burden. A capital accounting system only saves the taxpayer if it serves as an excuse for increasing the public debt.

The Voice of Experience

Abuse of extra-budgetary accounting, to spare the taxpayer but with the result of weakening the national credit and currency, has been common in European experience. In the United Kingdom, as a mild example, government outlays "below the line" or outside the regular budget have been a persistent source of inflationary pressure since the war. The regular budget has shown a respectable £3.3 billion surplus over the six years ended March 31, 1953. Nevertheless, though a precise total is not published, the gross debt, including guaranteed obligations issued to pay for nationalized undertakings, evidently has increased very considerably.

Writing in 1948 on "The Problem of Budgetary Reform in the United Kingdom", Professor J. R. Hicks, while espousing the principle of capital budgets, pointed out how the development of receipts and payments outside the ordinary British budget was threatening to deprive reported budget surpluses of any real meaning. Professor Hicks also took note of the dangers in abandoning the principle that expenditures should be financed out of taxation:

> Hitherto, excepting in time of war and post-war resettlement, it has always been possible for the Chancellor, when faced with a proposal to spend (say) £10 millions on some desirable object, to reply in these terms: 'If I agree with that proposal, I shall have to find £10 millions of additional revenue. Where am I to find it? Is there any source of revenue still open which I can expect the country to accept as the price of this expenditure?'
>
> The answer to this last question might be yes or no; but if it was answered in the affirmative, the decision to spend the money would have been made with a fair counting of the cost. But now, if the principle of meeting expenditure out of taxation is wholly abandoned without any other principle being put in its place, the cost would cease to be counted. Additional expenditure could always be met by enlarging the deficit.

This is by no means a new lesson. Even before World War I capital or extraordinary budgets had a bad name. Rene Sturm, in his classic, "The Budget" published in 1913, pointed out how easy it is, with double budgets, to shift expenditures from one to the other classification as changing theories or interests dictate. He quoted a Belgian statesman who likened the extraordinary budget to "the juggler's cup by means of which the Minister of Finance disposes of the deficit".

Mr. Ruml notes that cynics might characterize his budget plan as balancing by "definition". One does not need to be cynical to observe that this is what it would be. It would be difficult to get two experts to agree just where the line is to be drawn between ordinary and extraordinary — or to keep a definition once written. Mr. Ruml gets a total of $6 billion capital outlays to be financed out of borrowed money. Another expert, elastically, could find $12 billion or maybe $18 billion. Once the firm rule of balancing cash accounts is forsaken, there is no clear stopping point for deficit financing.

The balanced budget test is a hard test for national governments to meet. It demands a heavy tax load. It demands discretion in expenditure. The reward — protection from depreciating money and spiralling prices — is worthy of these costs and efforts. It would be a pity to give up on a goal so closely within reach.

U.S. Exports and Imports

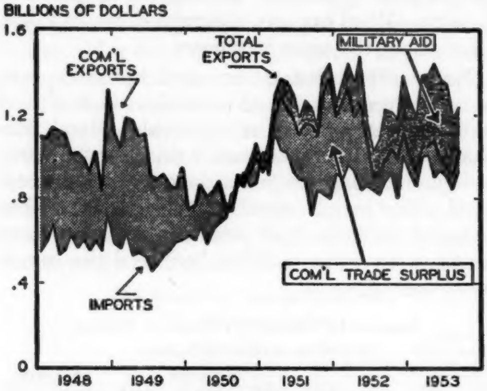
With all that is said these days about the need for "Trade, not Aid," and with the problem of U.S. foreign trade policy now under study by President Eisenhower's Commission on Foreign Economic Policy headed by Clarence B. Randall, a pertinent question is, what actually *is* happening to imports and exports?

This question is important both because of its relation to the position of the United States in the world economy, and because of the immediate effects in this country. For the first time perhaps in the postwar period, the development of more competitive markets everywhere is bringing home to the American people a real awareness of the foreign trade problem. The decline in our agricultural exports, with its bearish effects in piling up our farm surpluses and depressing prices, is a forceful reminder of the importance of exports in our economy. At the same time the upward tendency of imports, despite its contribution to maintenance of exports in the face of declining aid, is being viewed with concern by the lines affected, bringing mounting pressure for increased tariff protection or import quotas.

Commercial Exports Down

Turning first to the overall figures, it appears, on the basis of data available through September, that both exports and imports will set new high records in 1953.

For the first nine months of this year overall exports, including military shipments, reached an annual rate of nearly $16.0 billion. If this rate is maintained, the total for 1953 will exceed the previous record, set in 1947, as well as last year's figure, by approximately a half billion dollars. However, as shown in the chart on the next page, this expansion has been due entirely to growth of military shipments which contribute to industrial activity but earn no foreign exchange. Such shipments in the summer of this year reached an annual rate of almost $4.5 billion.



United States Foreign Trade by Months

From the standpoint of commercial trade the significant feature in 1953 has been the narrowing of the gap between non-military exports and imports. This development, dating back to mid-1952, marks a new phase in our postwar trade. As will be seen from the chart above, the change has been brought about principally by a decline in commercial exports, though a moderate increase in imports has also played a part.

Based on the first three quarters of 1953, commercial exports for the full year should reach $12 billion, only about $1 billion greater than imports, now anticipated to reach about $11 billion. Allowing for shipments paid for by U.S. economic aid — not separately reported — it is probable that this country for more than a year has had a small import balance in its "cash trade". This has not happened for any comparable period since the mid-thirties.

Sharp Decline in Farm Exports

More than half of the decline in commercial exports was accounted for by a drop in exports of farm products from the high level reached after the outbreak of the Korean war. The drop was particularly sharp in cotton exports, which in the first half of this year fell by 52 per cent compared with 1952, in grain exports which fell by 35 per cent, and in lard which dropped by 40 per cent. A few farm commodities — notably citrus fruits, tobacco, and corn — registered increases during the first half of 1953 over a year earlier.

Secretary of Agriculture Benson has listed five factors behind the decline in our farm exports: (1) a tendency abroad to reduce inventories; (2) decline in U.S. economic aid; (3) the desire of foreign countries to conserve dollars; (4) the fact that world prices for many of our farm products are below subsidized levels in this country; and (5) most important of all, the continued expansion of agricultural production abroad. Non-dollar exportable surpluses of foodstuffs have been rising both because Western Europe is becoming more self-sufficient in food and because of the recovery of production in the Southern Hemisphere.

The trends in agricultural and non-agricultural exports over the past three years are shown in the table below, together with comparisons with 1948, the last year of full business activity prior to Korea.

U.S. Exports by Main Divisions
(In Millions of Dollars)

	12 Months			9 Months	
	1948	1951	1952	1952	1953
Total Exports	12,653	15,032	15,176	11,380	11,868
Less: Military aid	—	1,065	1,988	1,337	2,840
Equals: Commercial exports*	12,653	13,967	13,188	10,043	9,028
of which:					
Agricultural†	3,473	4,040	3,427	2,569	1,820¶
Non-agricultural†	9,059	9,774	9,622	7,363	7,118¶

Non-Agricultural Exports by Selected Commodity Groups‡
(In Millions of Dollars)

	12 Months			8 Months	
	1948	1951	1952	1952	1953
Coal and products	492	605	510	372	280
Petroleum and products	657	783	793	544	462
Steel mill products	649	611	722	401	336
Wood & paper products	248	380	319	236	171
Machinery	2,807	2,500	2,711	1,882	1,851
Motor vehicles	899	1,182	987	713	672
Textile manufactures	844	817	656	436¶	420¶
Chemicals	780	981	801	562	506

* Including those special categories paid for by foreign countries. † Excluding reexports. ‡ Excluding all special categories. ¶ Partly estimated.

Trend of Non-Farm Exports

Exports of fuels and of industrial raw materials and semimanufactures likewise declined sharply this year compared with a year ago. Coal exports, which rose to an annual rate of over $700 million after Korea due to Western Europe's inability to satisfy expanded industrial and defense requirements, receded to $340 million this year as importing countries either increased their own production or turned to non-dollar sources. The decline in petroleum exports shown in the table reflects both larger Near East output and the coming into operation of new refineries abroad. Exports of steel mill products and of paper and paper base stocks increased immediately after the Korean outbreak due to scarcities and high prices abroad. With the softening of world prices and increased competition this business declined.

Contrasting with these not unexpected reductions in exports of raw and semi-finished goods is the showing made by chemicals, textile manufactures, motor vehicles, and particularly machinery and equipment — a broad classification that includes not only capital goods, such as industrial machinery and electric equipment, but also such consumer durable goods as refrigera-

tors and household appliances. Exports in these groups dipped sharply during the latter half of 1952 but recovered this year, though in most cases remaining below the peak levels reached during the first half of 1952.

Maintenance of our capital goods exports at a high level is noteworthy in view of the growing competition of West European, especially German, products. Canada is largely responsible for this, taking some 30 per cent more machinery and motor vehicles during the first half of 1953 than in the corresponding period of 1952. However, new export orders have been reported harder to get.

Record Imports Indicated

On the import side, the first nine months of 1953 reached an annual rate of $11 billion, which if maintained for the rest of the year would slightly exceed the previous record set in 1951. As will be seen from the table below, we are spending some 58 per cent more dollars this year for foreign goods than in 1948. Data on the physical volume, not reflecting the price inflation, are by far the highest on record. Sharpest increases in physical volume have been in manufactured and semimanufactured goods.

U.S. Imports by Main Divisions

	12 Months			9 Months	
	1948	1951	1952	1952	1953
Actual dollar value (in millions of dollars):					
Crude foodstuffs	$1,272	$2,077	$2,068	$1,524	$1,587¶
Manufact'd foodstuffs	731	1,022	1,082	838	897¶
Crude materials	2,147	3,364	2,937	2,241	1,997¶
Semimanufactures	1,633	2,458	2,566	1,838	2,115¶
Finished manufactures	1,309	1,896	2,094	1,522	1,628¶
Total	7,092	10,817	10,747	7,963	8,224
Dollar value as percentage of 1948					
Crude foodstuffs	100	163	163	169	176
Manufact'd foodstuffs	100	140	148	155	166
Crude materials	100	157	137	138	123
Semimanufactures	100	151	157	153	176
Finished manufactures	100	145	160	160	171
Total	100	153	152	152*	158*
Physical volume as percentage of 1948†				8 Months	
Crude foodstuffs	100	109	108	111	114
Manufact'd foodstuffs	100	134	141	148	156
Crude materials	100	102	109	106	105
Semimanufactures	100	134	138	130	161
Finished manufactures	100	130	146	146	163
Total	100	117	123	121‡	133‡

* First nine months of 1948 = 100. † Price factor eliminated.
‡ First eight months of 1948 = 100. ¶ Partly estimated.

The increase in imports during the first eight months of 1953, as compared with a year earlier, was well distributed over the major categories of merchandise. Exceptions to this general rise, as shown in the table below, were in crude materials – rubber, wool, textile fibers and manufacturers (which include such products as burlap) and cocoa. Rubber, wool and burlap imports have been cut in value by sharp price declines. Imports of rubber, while declining some 22 per cent in volume, were down 51 per cent in value. Wool imports, although down in value, were about the same in volume.

Noteworthy increases occurred in the imports, of nonferrous metals and ferroalloys and of steel mill products as well as chemicals. Metal purchases were stimulated earlier this year by heavy foreign offerings at prices below the domestic level. In recent months the situation has changed as a result of price declines and more cautious inventory policies here and the movement has fallen off.

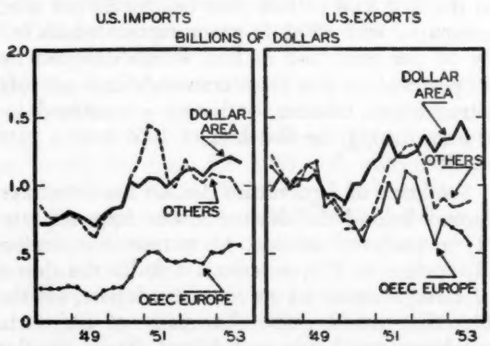
Imports by Selected Products or Groups

(In Millions of Dollars)

	12 Months			8 Months	
	1948	1951	1952	1952	1953
Coffee	$698	$1,862	$1,376	$896	$916
Sugar	313	387	416	324	333
Cocoa	194	197	178	136	124
Crude rubber	309	808	618	486	239
Raw wool	308	713	382	250	221
Other textile fibers and mfrs.	555	782	730	480	434
Sawmill products	152	229	222	135	161
Paper and products	754	958	926	602	618
Petroleum and products	416	601	692	449	486
Nonferrous metals and ferroalloys	778	963	1,562	996	1,179
Steel mill products	48	330	213	124	189
Machinery and vehicles	154	243	354	238	250
Chemicals & related prod.	111	301	244	164	208

Changes in Trade by Countries

The pattern of trade has varied widely from area to area, as will be seen from the following chart and table. Trade with the dollar area countries – which include Canada, the Philippines, and the Latin American Republics of Central America and the Caribbean – has been maintained near peak post-Korean levels. Business in these countries has been active, and their dollar earnings, being subject to little or no currency restrictions, are usually translated quickly into purchases of U.S. goods. During the first eight months of 1953 Canada bought some $264 million more from us than in the like period of 1952, Colombia $28 million more, and the Philippines some $46 million more.



United States Foreign Trade by Selected Areas

Western Europe has made substantial progress toward balancing its trade with the United States. If special category exports, largely military aid shipments, are excluded, Western Europe's trade deficit with us was cut to about $265 million during the first eight months of 1953. Our export surplus with the O.E.E.C. area in Europe for all of 1953 may come to less than $400 million, the lowest figure by far since the Second World War and considerably below the average in the late 'thirties.

U.S Trade by Selected Countries
(In Millions of Dollars)

	8 Months Exports to		8 Months Imports from		Excess Imp. (—) or Exp. (+)	
	1952	1953	1952	1953	1952	1953
Dollar area:						
Canada	1,812	2,076	1,530	1,636	+282	+440
Dollar Latin Amer.	1,567	1,462	1,391	1,493	+176	— 31
Philippines	188	234	169	192	+ 19	+ 42
The O.E.E.C. countries:						
United Kingdom	465	371	315	369	+150	+ 2
Belgium, Netherlands	400	301	221	290	+179	+ 11
West Germany	289	218	126	184	+163	+ 34
France	249	222	113	130	+136	+ 92
Others	800	581	398	457	+402	+124
Overseas Sterling Area	878	574	987	805	—109	—231
Japan	423	387	136	177	+287	+210
Southeast Asia (a)	467	524	513	466	— 46	+ 58
Near East	258	228	156	151	+ 97	+ 77
Non-dollar Latin Amer.	757	404	821	891	— 64	—487

Note: All special categories excluded. (a) Excluding sterling area countries.

The reduction in our export surplus with Western Europe has been due both to the decline in our commercial exports and to the rise in our purchases. In this the revival of production in Western Europe and the growing availability of goods for domestic consumption and for export have played the most important part. Restrictions against dollar goods, deliberate efforts to turn to non-dollar sources of imports, retrenchment policies, and more effective control of inflation have also been influential.

Based on figures through August, our imports from Western Europe for 1953 seem certain to be the largest on record. Imports from seven O.E.E.C. countries, including Belgium, Switzerland, the Scandinavian countries and Turkey, actually exceeded our commercial exports to them. Our trade with the United Kingdom was in balance, and that with the Netherlands approaching a balance.

From Dollar Shortage to Dollar Surplus

From the foregoing figures, it would seem that the period of huge export balances in U.S. foreign trade is drawing to a close. Moreover, with the merchandise or "visible" export surplus in non-military goods reduced to an annual rate around $1 billion, but with so-called "invisible" items and U.S. Government expenditures for military installations and maintenance of our troops abroad netting foreign countries $1 billion or more, it appears that our overall trade and service accounts with the rest of the world are now in balance. Temporarily at least, the much talked of "dollar gap" has been eliminated.

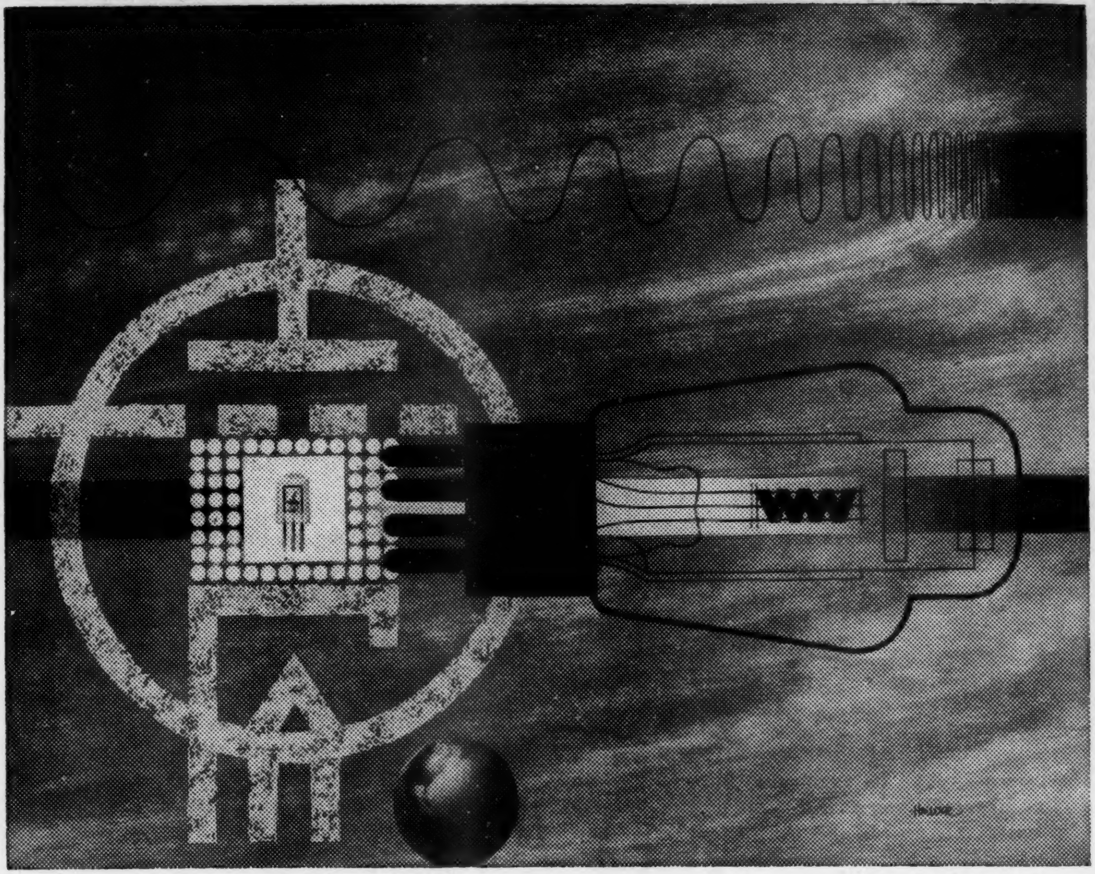
Additional dollars flowing abroad in the form of U.S. Government economic aid and private capital transactions have actually created a dollar surplus. Foreign countries have been accumulating gold and dollar resources at a rate in excess of $2 billion a year, thereby strengthening the underpinning of their currencies.

The question is, how permanent are these trends likely to be?

U.S. foreign economic aid is declining, and the outlook for long continuance of the present rate of U.S. military spending abroad is uncertain. American merchandise trade is meeting with increased competition both at home and in foreign markets. Imports, as we have seen, are tending to rise and, barring a business recession in this country which would reduce our purchases of foreign goods, this tendency seems likely to continue. Exports, on the other hand, have declined, due mainly to recovery of production abroad and to the ability of foreign customers to satisfy more of their needs at home or from sources outside this country.

While a continuing rise of foreign monetary reserves should lead to a gradual loosening of foreign import restrictions and to enlarged purchases in this country, the decline in U.S. economic aid may check the increase in foreign gold and dollar holdings. Thus any improvement over, or possibly even maintenance of, the present level of U.S. exports would seem largely to depend — among other factors such as relative prices, credit terms, and quality of merchandise — upon a further growth of U.S. imports, especially if and when U.S. military outlays abroad begin to taper off.

All this poses again — but more urgently, as competition increases — the old familiar issue of trade liberalism versus protectionism. It emphasizes the importance of the task undertaken by the Randall Commission in charting a broad foreign economic program for this country, and explains why its report expected early next year is eagerly awaited by business interests and policy-making officials in this country and abroad.



Electronics . . . *and The National City Bank of New York*

Midget electronic marvel is making science-fiction stories come true

A tiny electronic device called the transistor has brought the magical world of robots much nearer than most people realize. No bigger than half a pea, this electronic marvel may make it practical for mechanical brains to run factories, operate inventory and warehouse control systems, read utility meters, make out bills, and perform other equally amazing feats.

The transistor does about the same work as a vacuum tube. But it takes up much less space, uses much less power, generates almost no heat, and lasts almost indefinitely. Consequently, it holds out the promise of smaller, lighter, more durable designs in electronic equipment like radio and television sets. It also extends the electronics frontier tremendously.

How rapidly that frontier has already been expanding may be gleaned from the fact that in 1939 total production of electronic equipment totaled about $300 million. Last year production was over $4.5 billion, and the total could reach more than $5 billion this year.

Like fast-growing companies in other fields, electronics manufacturers have found National City's $6 billion in resources, 141 years of experience, and world-wide banking facilities invaluable. Facilities include 57 Branches overseas, and correspondent banks in every commercially important city of the world. In this country, National City has correspondent banks in every state and 68 Branches in Greater New York. For help in solving your banking or financial problems, large or small, write:

The National City Bank of New York,
55 Wall Street, New York City.

Member Federal Deposit Insurance Corporation

First in World Wide Banking

Printed in U. S. A.

End